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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

COMMENTS OF DISCOVERY COMMUNICATIONS, INC.

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September 30, 1993

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COMMENTS OF
DISCOVERY COMMUNICATIONS, INC.

Discovery Communications, Inc. ("Discovery"), by its attorneys, hereby submits its comments in response to the Third Notice of Proposed Rulemaking in the above-captioned proceeding.[1] In this Third NPRM, the Commission proposes several refinements to its benchmark/price cap scheme that are crucial to the continued growth of program services. As set forth below, Discovery fully supports the FCC's attempts to preserve cable operators' marketplace incentives to increase investment in a range of high-quality programming.

I. INTRODUCTION AND SUMMARY

Discovery, as explained in its earlier filings in this docket, operates the Discovery Channel and The Learning Channel. As a provider of innovative and informative program services, Discovery is precisely the kind of programmer that

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[1] First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-428 (released August 27, 1993) ("Third NPRM," "NPRM" or "Reconsideration Order").

Congress, in enacting the Cable Television Consumer and Protection and Competition Act of 1992,[2] sought to promote or -- at the very least -- not to affect adversely. Unfortunately, however, the Commission's rate regulations as presently structured may unintentionally create disincentives to cable operators' increasing their investment in program services. Discovery submits comments in this proceeding to urge the FCC to reduce these disincentives to the greatest extent possible. Specifically, Discovery supports the FCC's proposed benchmark adjustment for the addition of channels, albeit with some reservation. Discovery also continues to urge the Commission to allow a reasonable mark-up on programming cost increases.

II. THE COMMISSION HAS CLEARLY RECOGNIZED THE IMPORTANCE OF ROBUST OPERATOR INVESTMENT TO THE CONTINUED GROWTH OF PROGRAM SERVICES

An essential premise of the 1992 Cable Act is that the pervasive regulation of cable operators should not impair the quality or diversity of cable programming. Indeed, Congress explicitly stated that a core objective of the Act is to "promote the availability to the public of a diversity of views and information through cable television" and, specifically, to "ensure that cable operators continue to

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[2] Pub L. No. 102-385, 106 Stat. 1460 (1992) (the "Act" or "1992 Cable Act").

expand, where economically justified, their capacity and the programs offered over their cable systems." 1992 Cable Act at §§ 2(b)(1), 2(b)(3).

These Congressional policy goals embrace each of the two basic ways in which cable operators enhance viewers' choices. First, operators increase the diversity of information delivered to subscribers by adding new channels. Second, operators promote the quality of program services by supporting programmers' efforts to produce a high-quality, high-value product. Indeed, the House Committee, in prescribing rate regulation provisions, specifically recognized the beneficial dynamics of this relationship between operators and programming by noting that "since cable rates were deregulated in 1986 there has been an increase in the quality and diversity of cable programming."[3]

In accordance with these policy directives and findings of Congress, the FCC has attempted to limit the harmful effect of the rate regulations on program services by adopting rules that "permit the continued growth of [cable] services." Rate Order and Further Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-177 (released May 3, 1993 ('Rate Order") at ¶ 9. For example, in according external treatment to programming cost increases, the

[3] H.R. Rep. No. 628, 102d Cong., 2d Sess. 86 (1992) ("House Report").

Commission stated that "we attach greater importance at this initial stage of rate regulation to assuring the continued growth of programming" than to the rate impact resulting from such a pass-through. Id. at ¶ 215. Similarly, the agency emphasized its commitment to ensuring the continued growth of programming in adopting a flexible, market-based rule to govern affiliate transactions. Reconsideration Order at ¶ 114.

As the Third NPRM implicitly acknowledges, however, a number of the rate regulations adopted to date could inadvertently hinder increased investment in programming by reducing or eliminating operators' marketplace incentives to investing in program services.[4] The NPRM identifies two distinct unresolved issues that significantly affect investment in programming under the benchmark system. First, the Rate Order did not provide guidance on how to adjust rates under the benchmark scheme when channels are added. In the Third NPRM the Commission addresses this issue and proposes alternative approaches and tentatively selects a preferred method for adjusting rates. Third NPRM at ¶¶ 133-144. Second, the agency had yet to determine whether, to preserve operators' marketplace incentives to increase investment in already-carried program services, programming

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[4] Cf. Rate Order at ¶ 25 (recognizing that rate regulations might inadvertently impair programmers' ability to develop and produce programming).

cost increases should be subject to a mark-up or profit margin. The Third NPRM seeks comment on the adoption of such a mark-up mechanism. Id. at ¶ 135 n.244. The Third NPRM thus reflects the FCC's understanding that the addition of channels and investment in the quality of channels already carried are indeed two distinct issues.

III. THE COMMISSION APPROPRIATELY SEEKS TO ENSURE THAT ITS BENCHMARK ADJUSTMENT ALLOWS OPERATORS TO RECOVER THEIR ACTUAL PROGRAMMING COSTS WHEN ADDING CHANNELS

Discovery supports a method for adjusting the benchmark rates when channels are added to cable systems that preserves fully marketplace incentives to adding channels. The Third NPRM discusses three approaches to adjusting the benchmark rates in this situation and tentatively concludes that the last of these three approaches should be adopted. Although Discovery prefers the first approach because it would best preserve incentives for adding channels, Discovery nonetheless accepts the Commission's third approach as an adequate means for recovery of the increased programming costs, but not the non-programming costs, inherent in adding channels to a cable system.

Each of the three approaches discussed in the NPRM would look to the benchmark tables in setting a new permitted rate after an operator adds channels to its regulated cable service. The first of the three approaches discussed in the

NPRM would price existing channels at current permitted rates, but price new channels at the lower marginal benchmark rate corresponding to the new total number of channels on the tier. The second approach would price both existing and new channels -- without regard to the current permitted rate -- at the lower marginal benchmark rate corresponding to the new total number of channels. The third approach would price all channels at a marginal rate calculated by reducing the current permitted rate (less existing programming costs) by an amount proportionate to the decline in the benchmark rate resulting from the added channels, and then adding to this base the new total programming costs per channel. Third NPRM at ¶¶ 135-144.

Discovery favors the first approach to the extent that, in addition to offsetting programming costs, it provides operators a source of revenue under the benchmark system to offset the capital improvement costs incurred in expanding system capacity. The addition of channels generally involves construction of increased system capacity, which in turn depends on a ready means of recovering the construction costs. Operators that are forced to recover capital improvement costs only through burdensome cost-of-service showings will be discouraged from building capacity to add channels. The best benchmark adjustment would allow operators to recover more than just their programming costs.

The Commission's tentative decision not to adopt this approach, however, renders it all the more critical that the Commission at least allow operators to recover capital improvement costs, as it has proposed, through streamlined cost-of-service showings.[5]

Discovery respectfully submits that the second approach should be rejected out of hand as completely contrary to the policy of the 1992 Cable Act and the rationale of the Rate Order. Because the benchmark rate declines as channels are added, thus lowering operators' marginal revenue for all existing services, this method would simply makes things worse and create a powerful disincentive to add channels by requiring operators with current permitted rates above the benchmark level to lower their rates to the benchmark when channels are added. This would almost guarantee that operators with current permitted rates above the benchmark only offer new services on an unregulated, a la carte basis. Not only would this result squarely contravene the programming policy goals, it also would render nugatory the Rate Order's sound determination not to require systems with above-benchmark rates to lower their rates fully to benchmark levels.

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[5] For the same reason, Discovery also urges the Commission to adopt the proposals discussed in the Third NPRM to accord external treatment to franchise-required upgrades, consistent with the rules as clarified in the Reconsideration Order. See Third NPRM at ¶¶ 153-154.

Discovery supports the third approach as a reasonable method of achieving the narrow goal of ensuring that operators recover their additional programming costs when new services are added. This approach would remove a fundamental obstacle to operators' addition of new and innovative services like The Learning Channel. The third approach, however, does not even attempt to account for other disincentives to adding services under the benchmark scheme, such as the ability to recover readily the capital improvement costs that generally are a prerequisite to adding channels to a system. While the incremental revenue provided operators under the third approach seeks precisely to offset programming costs, it surely cannot offset the substantial costs incurred in increasing system capacity to the same extent that the first approach could. Notwithstanding this shortcoming, Discovery supports the Commission's adoption of this approach, as it serves the limited, but essential, function of permitting operators to recover the additional programming costs incurred when channels are added to their systems.

IV. TO ENSURE CONTINUED INVESTMENT IN THE QUALITY OF EXISTING PROGRAM SERVICES, OPERATORS SHOULD BE PERMITTED A REASONABLE PROFIT ON PROGRAMMING COST INCREASES

Discovery again urges the FCC to preserve operators' marketplace incentives to purchase high quality, high-value programming by allowing operators to earn a reasonable profit on programming costs. See, e.g., Comments of Discovery in MM Docket No. 93-215. Below, Discovery offers its considered response to the Commission's effort in the Third NPRM to address the various practical issues raised by a mark-up mechanism.

As the Commission and a range of commenters have recognized, there are compelling reasons to allow operators to earn a profit on programming cost increases.[6] In the absence of a reasonable mark-up, operators' incentive to increase investment in programming is greatly diminished. Although the Commission has accorded external treatment to programming cost increases beyond inflation -- thereby ameliorating operators' disincentive to purchase growing, high-quality program services -- operators remain precluded from earning any profit on these expenditures. Indeed, this raises the distinct possibility that, over time, whatever profit margin initially exists under the benchmark will erode.

Moreover, a mark-up mechanism is consistent with the Commission's asserted goal of producing rates that are comparable to those that would prevail under competitive conditions. See, e.g., Reconsideration Order at ¶ 12; Rate

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[6] Third NPRM at ¶ 135 n.244. A logical mark-up level would be that of the rate-of-return ultimately adopted in the cost-of-service proceeding.

Order at ¶ 14, 15. Indeed, as the Commission recognized in the Reconsideration Order, "competing businesses must charge rates that are designed to cover all relevant costs and to provide for a profit in order to remain in business." Reconsideration Order at ¶ 13.

The NPRM questions whether affiliated programming expense increases should be treated differently than non-affiliated increases for purposes of a mark-up. Third NPRM at ¶ 135 n. 144. Discovery respectfully submits that no basis exists to distinguish between the affiliation of programmers. In the Reconsideration Order, the FCC adopted a safeguard that prevents vertically-integrated programmers from acting on any incentives they might have to artificially inflate prices charged to affiliated operators. See Reconsideration Order at ¶ 114. Under that safeguard, operators may pass through increases in the cost of programming from affiliated entities that exceed inflation only to the extent that the price charged to the affiliated system reflects prevailing marketplace prices or the fair market value of the programming. Id. This rule, which is based on the FCC's decision to "adopt an initial regulatory approach that is somewhat more liberal in permitting external treatment of affiliated programming costs", obviates the need for additional restrictions. Id. Moreover, the Commission should be especially wary of imposing unnecessary limitations on affiliated program transactions given the essential role that vertically-integrated operators play in development of high quality, diverse program services. Indeed, the House Report cited The Discovery Channel as an example of "innovative programming services that would not have been feasible without the financial support of cable system operators." House Report at 41.

The NPRM also considers the appropriate treatment of advertising and other provisions of programming contracts that affect the level of programming expense. Discovery submits that, consistent with the Rate Order, sums paid to operators by programmers at the "point-of-transaction" as consideration for programming purchases -- such as promotional money -- may reasonably be netted against cost increases. See Rate Order at ¶ 253 n.602. The Rate Order requires that revenue received from a programmer for the carriage of programming be netted against costs for purposes of determining cost increases or decreases. See 47 C.F.R. 76.922(d)(2)(vii). This rule should apply here as well. However, advertising revenue should not be offset. These monies are not received for carriage of programming, but rather derive from local cable operator sales efforts.

V. CONCLUSION

For the foregoing reasons, Discovery respectfully requests the Commission to adopt the proposals advocated herein so that, despite the advent of rate regulation, cable operators will continue to invest in program services, thereby increasing the quality and diversity of cable programming.

Respectfully submitted,

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